MEMO# 28060

April 23, 2014

Draft ICI and ICI Global Comment Letter on European Commission's Consultation Paper on FX Financial Instruments - Member Feedback Requested by Wednesday, April 30

[28060]

April 23, 2014

TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 29-14
ICI GLOBAL MEMBERS No. 16-14
INTERNATIONAL COMMITTEE No. 11-14 RE: DRAFT ICI AND ICI GLOBAL COMMENT LETTER ON EUROPEAN COMMISSION'S CONSULTATION PAPER ON FX FINANCIAL INSTRUMENTS - MEMBER FEEDBACK REQUESTED BY WEDNESDAY, APRIL 30

On April 10, the European Commission issued a consultation paper on foreign exchange ("FX") instruments under the Markets in Financial Instruments Directive ("MiFID"). [1] Specifically, the Commission is requesting views on the boundary between an FX spot and an FX forward. As we previously informed you, the European Securities and Markets Authority ("ESMA") requested that the Commission adopt measures to clarify whether the definition of "derivatives" for purposes of the European Market Infrastructure Regulation ("EMIR") would cover certain FX forwards and physically settled commodity forwards. [2]

We have prepared a draft comment letter in response to the Consultation Document, which is attached. We plan to file this comment before the May 9 comment period deadline. If you have comments on the draft letter, please provide them to Jennifer Choi at jennifer.choi@ici.org by Wednesday, April 30.

The letter will be submitted on behalf of U.S. funds that are regulated under the Investment Company Act of 1940 ("ICA") and non-U.S. regulated funds publicly offered to investors (collectively, "Regulated Funds"). The draft comment letter states that international coordination among regulators in implementation of derivatives reform is critical to the derivatives market by helping to alleviate duplicative and potentially conflicting regulation of transactions that are conducted on a cross-border basis (which are the majority of derivatives transactions). The letter encourages the Commission to adopt a definition of an FX spot transaction that is substantively similar to the definition adopted by the Commodity

Futures Trading Commission ("CFTC"). The letter requests that the Commission adopt generally two business days delivery as the delineating period for a spot contract with important exceptions. [3] Specifically, the Commission should deem an FX transaction that is entered into in connection with investment in a foreign security to be a spot transaction ("Securities Conversion Transaction") and not subject to regulation under EMIR. The letter explains that these transactions typically have very short settlement cycles, which present lower risks to the counterparties and to the financial markets more generally. Requiring these transactions to comply with the requirements under EMIR and with other derivatives regulations would add operational complexity and unnecessary cost without providing any significant protection to market participants. In addition, inconsistent treatment of Securities Conversion Transactions by global regulators may cause dealers to limit Securities Conversation Transactions to T+2 spot transactions, reducing the ability of Regulated Funds to make foreign investments efficiently.

Jennifer S. Choi
Senior Associate Counsel Securities Regulation

Attachment

endnotes

[1] Consultation Document, FX Financial Instruments, European Commission, April 10, 2014, available at http://ec.europa.eu/internal_market/consultations/2014/foreign-exchange/docs/consultation-document_en.pdf ("Consultation Document").

[2] Letter from Steven Maijoor, Chair of European Securities and Markets Authority, to Michael Barnier, Commissioner for Internal Market and Services, European Commission, dated February 14, 2014, available at http://www.esma.europa.eu/system/files/2014-184_letter_to_commissioner_barnier_-_classification_of_financal_instruments.pdf. For a summary of the ESMA letter and the Commission's response, see ICI Memoranda Nos. 27895 (Feb. 18, 2014), available at http://www.ici.org/my_ici/memorandum/memo27895 and 27980 (Mar. 25, 2014), available at http://www.ici.org/my_ici/memorandum/memo27980.

[3] The Commission notes that two business days delivery appears to be the most widely used delineation for a spot contract. The CFTC also takes the view that "[i]n general, a foreign exchange transaction will be considered a bona fide spot transaction if it settles via an actual delivery of the relevant currencies within two business days." Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208 at 48257, available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-18003a.pdf ("CFTC Release Adopting Definition of Swap"). The CFTC also provided interpretive relief that an FX transaction that is settled on the customary timeline of the relevant spot market is not with the definition of the term "swap." The CFTC also will consider an FX transaction that is entered into solely to effect the purchase or sale of a foreign security to be a bona fide spot transaction where certain conditions are met. Id. We understand that there are a number of complex interpretive questions/issues that arise from the conditions imposed by the CFTC, and we urge the Commission not to incorporate these conditions into its standards.

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